

March 14, 2013

# Orange Unified School District

## Overview of California Education Finance

### **Keygent LLC**

999 N. Sepulveda Blvd., Suite 500

El Segundo, CA 90245

(310) 322-4222



# Table of Contents

---

<b><u>Section</u></b>	<b><u>Page</u></b>
I. Introduction to Keygent	3
II. General Obligation Bond Overview	6
III. Recent Negative Press & Pending Legislation	22

# Section I

---

## Introduction to Keygent

# Keygent Advisors Overview

---

Keygent Advisors (“Keygent”) is an independent financial advisor with a **sole focus** on California education entities

- ◆ Specializes in providing independent strategic and technical financial advisory/structuring services
- ◆ Headquartered in El Segundo with an additional office in San Francisco
- ◆ Keygent’s professionals have worked with over 500 California educational entities over the past 20 years and have over 80 years of combined experience
  - Since 2008, we have structured over 300 California education financings totaling over \$8 billion
- ◆ Keygent serves as financial advisor to numerous large California K-14 general obligation bond programs
  - Tustin USD, Long Beach USD, Fresno USD, Santa Monica-Malibu USD, Clovis USD, Fremont USD, Glendale USD, San Mateo UHSD, Palo Alto USD, Beverly Hills USD
- ◆ Keygent’s professionals are highly trained in quantitative analysis and have structured hundreds of general obligation bonds, bond anticipation notes (“BANs”), certificates of participation (“COPs”), tax and revenue anticipation notes (“TRANS”), and refundings

# Unique Qualifications

---

## Underwriting Experience

- ◆ As former underwriters, Keygent's senior advisors have:
  - An in-depth understanding of the financing process
  - Familiarity with the intricacies and risks of bond financings
  - Effective communication skills

## Technical Expertise

- ◆ Application of high level quantitative analytics
- ◆ Innovative ideas

Keygent serves solely as a financial advisor; unlike numerous other financial advisory firms, we are **not** a campaign strategist, state facility funding consultant, special tax consultant, facility master planner, construction program manager, or investment bank serving as financial advisor

## Section II

---

### General Obligation Bonds Overview

# What is a General Obligation Bond?

---

A general obligation bond is a common method of debt financing used by California school districts to generate capital project funds

- ◆ Lowest borrowing cost of any debt financing technique available to school districts
- ◆ Funds are available when bonds are issued
  - Typically sold in increments to meet district project needs
- ◆ Requires approval of the District's registered voters
  - Bond authorization amount
  - Project list
  - Estimated Tax Rate
- ◆ Repayment (principal and interest) is made from taxes levied on assessed valuation ("AV") of properties within the District's boundaries

# Types of General Obligation Bond Elections

## Proposition 46

## Proposition 39

	Proposition 46	Proposition 39
Board Approval Threshold	◆ Simple majority of members present	◆ Two-thirds of total members
Voter Approval Threshold	◆ Two-thirds	◆ 55%
Election Dates	◆ Any Tuesday	◆ Statewide primary, general, special, or regularly scheduled local elections
Use of Bond Proceeds	<ul style="list-style-type: none"> <li>◆ Acquisition or improvement of real property only</li> <li>◆ No furnishings or equipment</li> </ul>	<ul style="list-style-type: none"> <li>◆ Construction, reconstruction, rehabilitation or replacement of school facilities</li> <li>◆ Furnishings and equipment</li> <li>◆ Acquisition or lease of real property</li> </ul>
Accountability Measures	◆ None	<ul style="list-style-type: none"> <li>◆ Citizens Oversight Committee</li> <li>◆ Annual audits</li> </ul>
Annual Tax Rate Limits per \$100,000 of AV	◆ None	<ul style="list-style-type: none"> <li>◆ \$60 for unified school districts</li> <li>◆ \$30 for elementary and high school districts</li> <li>◆ \$25 for community college districts</li> </ul>



# Bond Program Considerations

---

General obligation bond programs are structured based on projections of:

- ◆ **District facility needs**
  - Construction cash flow vs. timing and amount of bond sales
  - Other funds available to the District
- ◆ **Authorization amount**
  - Principal amount of bonds approved by District voters
  - Usually split up into several issuances based on facility needs and bond program assumptions
- ◆ **District AV**
  - Projected AV growth has a significant effect on the bond issuance schedule and amounts
  - Determines statutory bonding capacity
- ◆ **Tax rates**
  - Estimated to registered voters as part of bond measure
  - Based on AV, bond issuance schedule and issuance amounts
- ◆ **Municipal bond interest rates**
  - Function of:
    - National and international financial market factors
    - District credit ratings
    - Bond structure, e.g. bond type, financing term and redemption feature

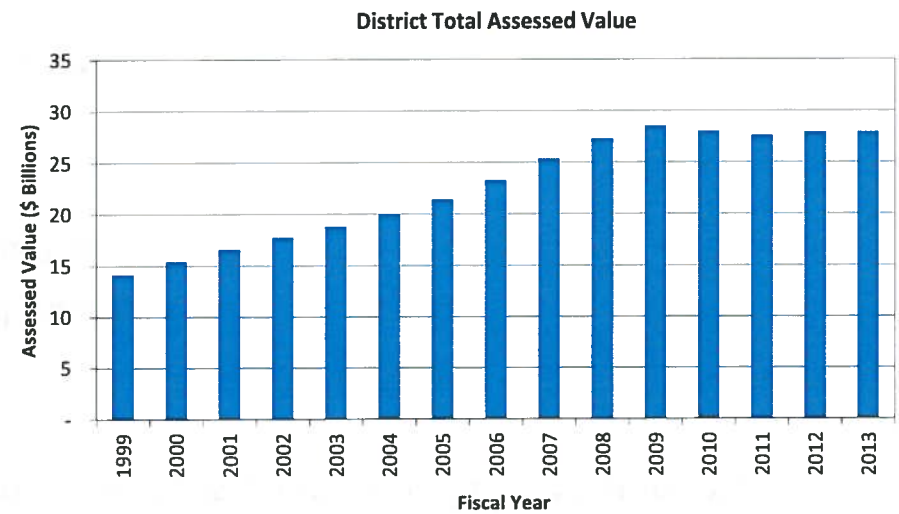
*As the above factors change, the timing of bond sales and the amount of bonds sold can be tailored to maintain tax rate targets*

---

# Orange Unified School District AV

District AV has recently been negatively affected by the real estate decline

FY	Total Secured <sup>(1)</sup>	Annual % Change	Unsecured <sup>(1)</sup>	Annual % Change	Total Assessed Value <sup>(1)</sup>	Annual % Change
1999	\$ 13,331,722,926		\$ 820,906,801		\$ 14,152,629,727	
2000	14,508,548,207	8.83 %	900,976,910	9.75 %	15,409,525,117	8.88 %
2001	15,628,165,927	7.72	969,497,001	7.61	16,597,662,928	7.71
2002	16,769,532,929	7.30	953,957,031	-1.60	17,723,489,960	6.78
2003	17,827,128,828	6.31	966,689,602	1.33	18,793,818,430	6.04
2004	18,982,081,592	6.48	1,003,368,202	3.79	19,985,449,794	6.34
2005	20,438,267,426	7.67	982,107,334	-2.12	21,420,374,760	7.18
2006	22,308,365,029	9.15	1,000,369,123	1.86	23,308,734,152	8.82
2007	24,256,211,130	8.73	1,122,036,953	12.16	25,378,248,083	8.88
2008	26,115,515,770	7.67	1,193,609,962	6.38	27,309,125,732	7.61
2009	27,365,839,302	4.79	1,170,623,541	-1.93	28,536,462,843	4.49
2010	26,787,562,637	-2.11	1,235,904,322	5.58	28,023,466,959	-1.80
2011	26,481,184,176	-1.14	1,154,829,302	-6.56	27,636,013,478	-1.38
2012	26,820,535,429	1.28	1,102,745,426	-4.51	27,923,280,855	1.04
2013	26,904,598,098	0.31	1,034,604,695	-6.18	27,939,202,793	0.06



### Growth Statistics

#### Annualized Growth Rates:

1-year:	0.06 %
5-year:	0.46
10-year:	4.04

#### Lowest Rolling Averages:

3-year:	-0.72 %
5-year:	0.46
10-year:	4.04

(1) Source: California Municipal Statistics, Inc.; Data from 1999 to 2013.

# Orange Unified School District Bonding Capacity

---

The District's bonding capacity is a **statutory** limit on the amount of general obligation bonds that can be issued

- ◆ Based on:
  - Current AV multiplied by statutory debt limit factor
  - Less: outstanding general obligation bonds
- ◆ Statutory debt limit factor of 2.5% of AV for unified school districts

## Estimated Current Bonding Capacity

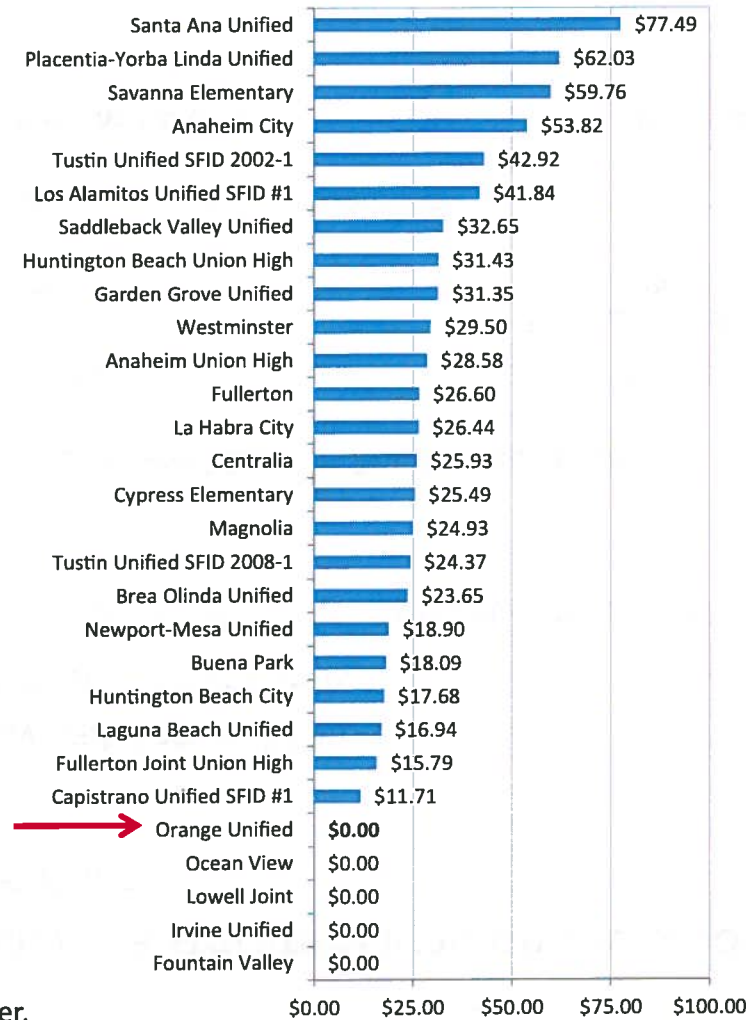
2012-13 Total AV	\$ 27,939,202,793
Statutory Debt Limit Factor	x 2.50%
Bonding Capacity	<u>698,480,070</u>
Less: Outstanding General Obligation Bonds	-
<b>Available Bonding Capacity <sup>(1)</sup></b>	<b>\$ 698,480,070</b>

(1) Subject to confirmation by the Orange County Auditor-Controller.

# Orange County School District Tax Rates (1)

The District is one of a few school districts within the County that does not currently levy a tax to pay debt service on general obligation bonds

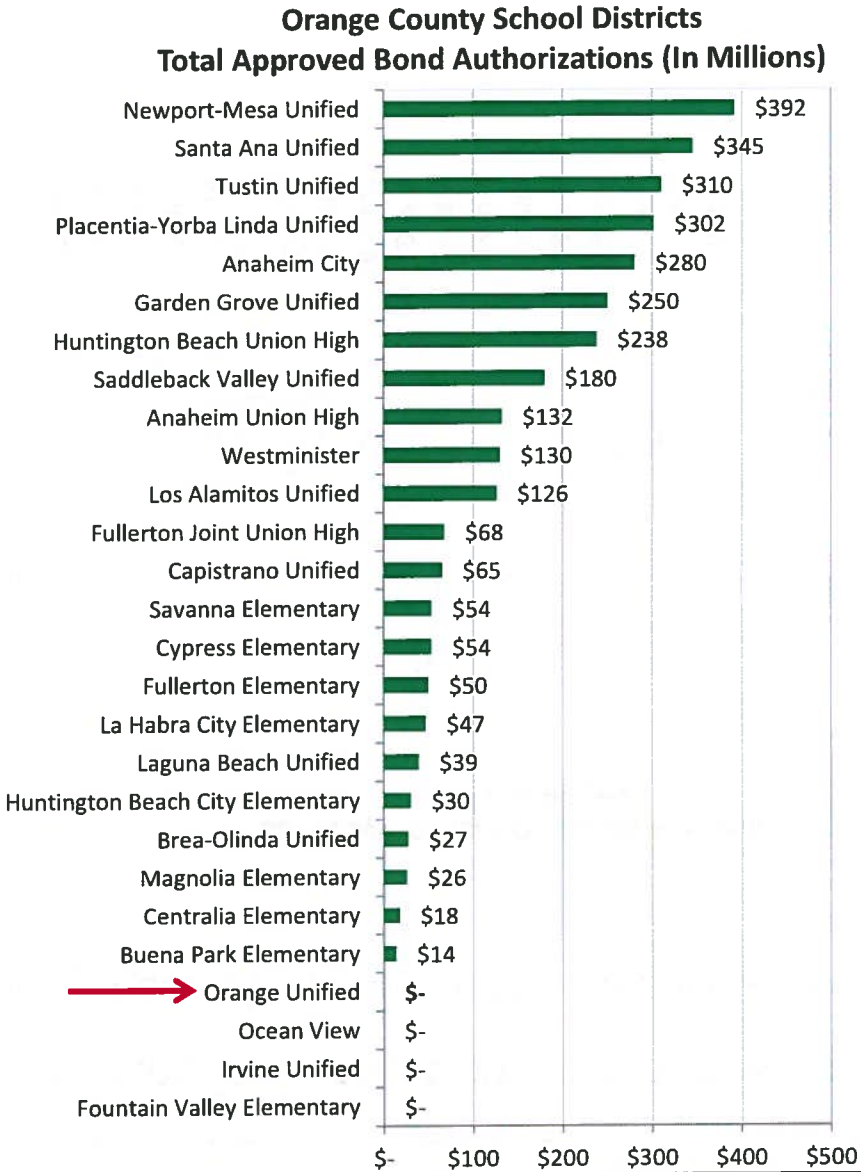
Orange County School Districts 2012-13 Tax Rates



(1) Source: Orange County Auditor-Controller.

# Orange County School District Bond Authorizations (1)

Following is a listing of approved bond authorizations for Orange County school districts

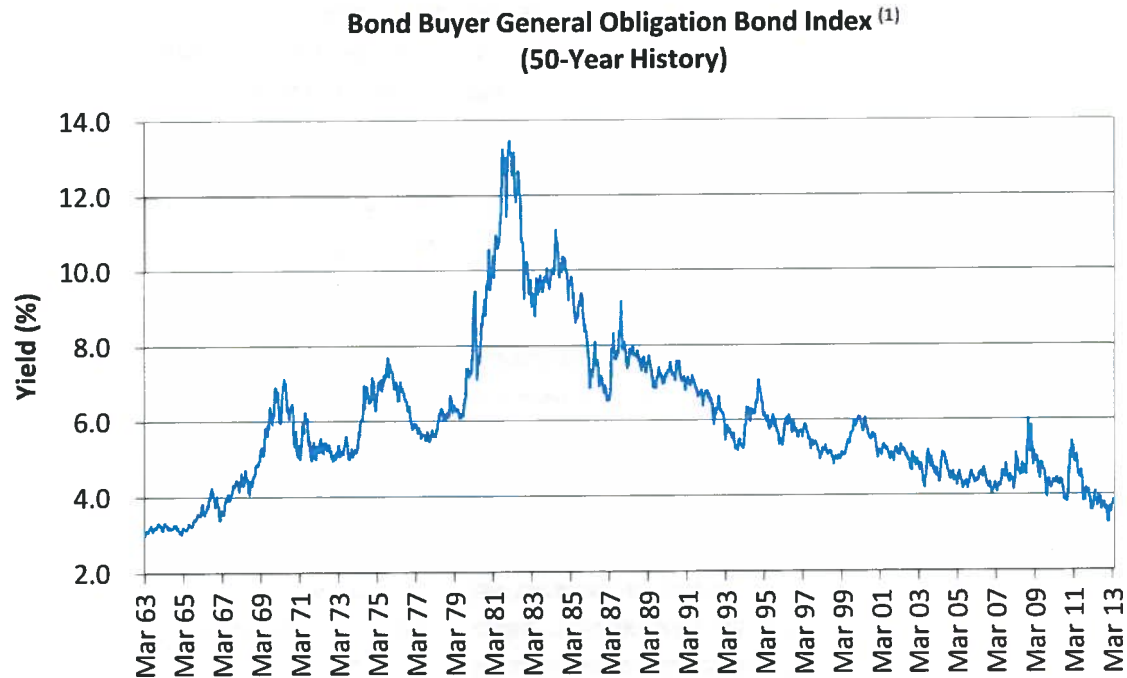


(1) Source: Ed-Data.

# Interest Rates

Municipal bond interest rates for current interest bonds are near historic lows

- ◆ Note: school district general obligation bonds are only issued as fixed-rate bonds



(1) Index reflects average yield to maturity of a sample of 20 general obligation bonds with 20-year maturities rated Aa2 by Moody's Investors Service and AA by Standard & Poor's. Source: The Bond Buyer & Bloomberg.

# Types of General Obligation Bonds

---

General obligation bonds are generally issued as either current interest bonds or capital appreciation bonds

- ◆ Current interest bonds (“CIBs”)
  - Interest paid semiannually
  - Principal paid at maturity
- ◆ Capital appreciation bonds (“CABs”)
  - Interest paid at maturity
  - Principal paid at maturity

# Structuring Bond Programs

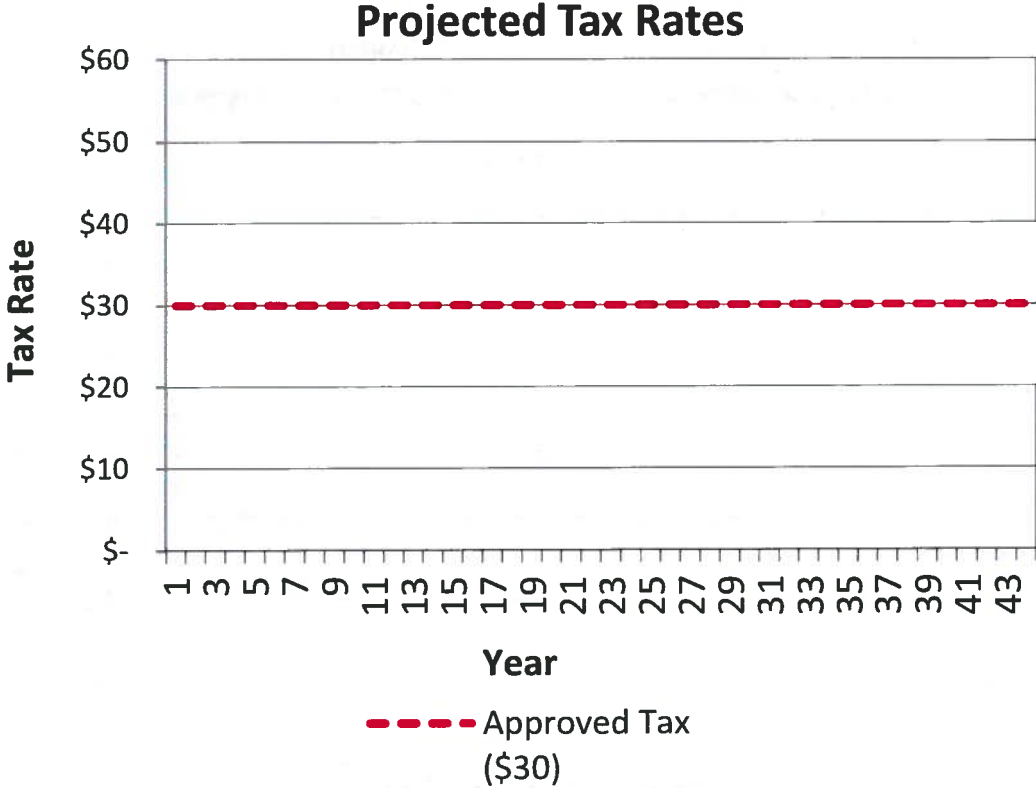
---

When voters approve a bond measure, they approve a maximum tax rate target

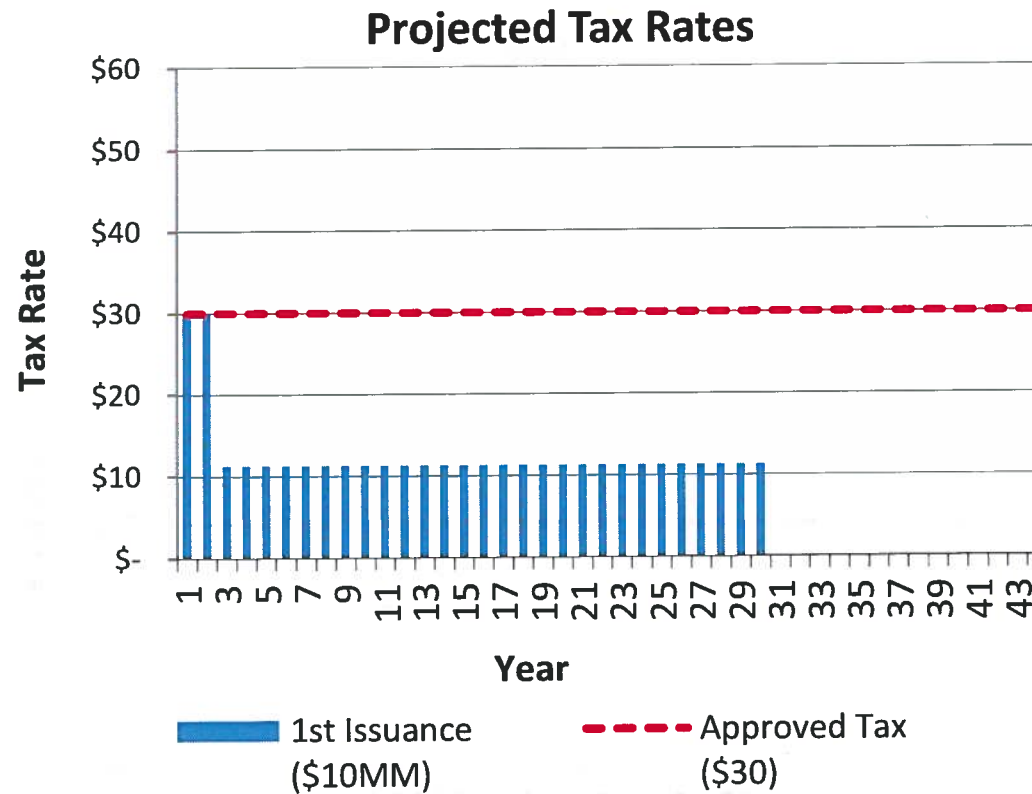
- ◆ Bond series are structured around each other to maintain this target tax rate
- ◆ As upfront tax capacity is utilized, later financings have more deferred payments



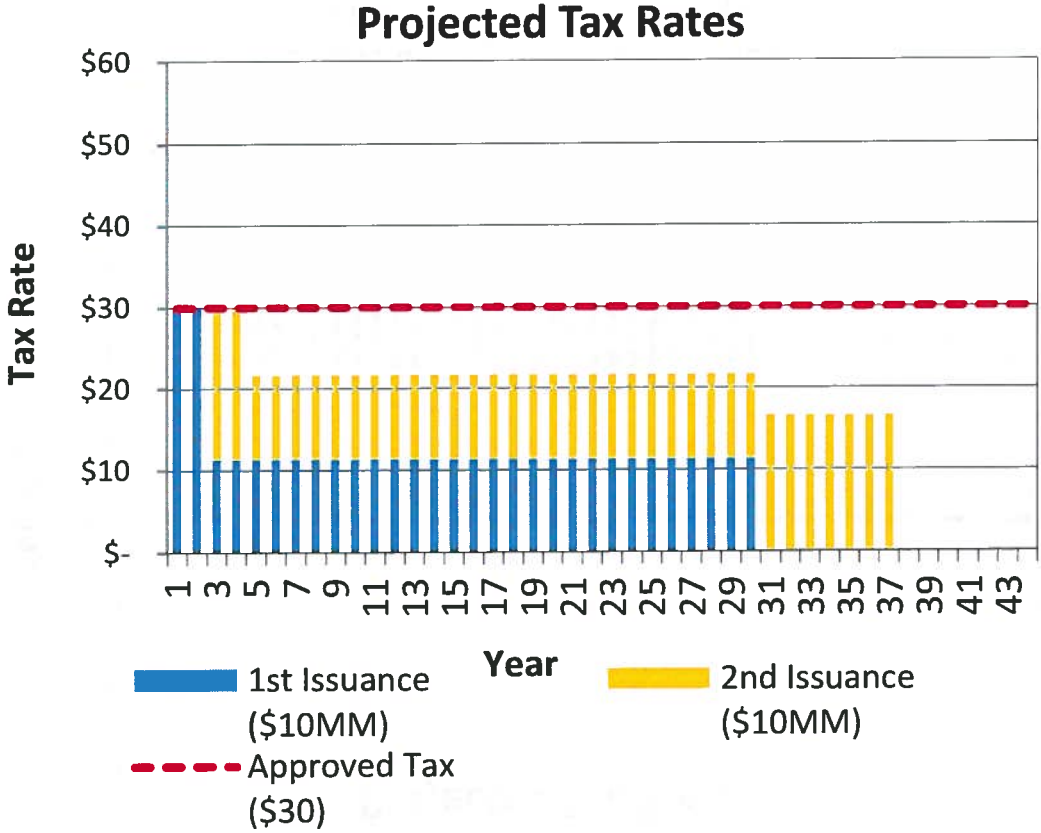
# Hypothetical Bond Program Structuring Illustration



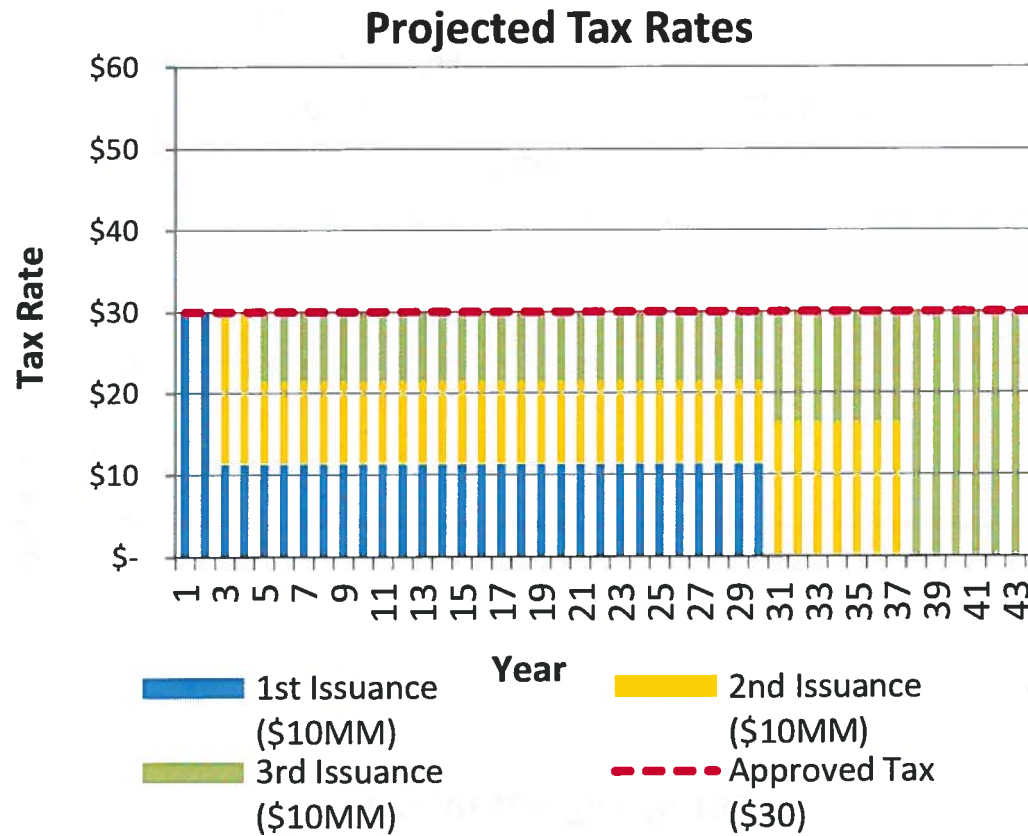
# Hypothetical Bond Program Structuring Illustration



# Hypothetical Bond Program Structuring Illustration



# Hypothetical Bond Program Structuring Illustration



# Competitive vs. Negotiated Sales

---

## ◆ Negotiated Sale

- The District selects an underwriter prior to the sale date of the bonds
- The District enters into a purchase contract with the underwriter on agreed terms and conditions of the bonds
- The underwriter works with potential investors before the sale date of the bonds to “pre-market” the District’s bonds
- Allows flexibility to make adjustments to the financing structure or timing leading up to the actual sale

## ◆ Competitive Sale

- An underwriter is not brought into the financing until the sale date of the bonds
- A notice of sale is published 1-2 weeks in advance of the scheduled sale date inviting bids for the bonds specifying terms and structure of bonds
- The bonds are sold to the lowest cost underwriter on the sale date of the bonds

## Section III

---

### Recent Negative Press & Pending Legislation

# Recent Negative Press on CABs

---

In August 2011, a California school district issued approximately \$105 million of CABs that matured in years 22 to 40

- ◆ Total repayment cost of principal and interest totaled approximately \$981 million
  - Repayment ratio of 9.35 to 1
- ◆ Bonds issued as non-callable

Significant negative press since August 2012 from major news outlets targeting California school and community college districts' use of CABs

# Proposed Legislation to Change Bond Financings

---

On January 17, 2013, the California Department of Education circulated a letter urging school districts to self-impose a moratorium on issuing CABs until new statutory requirements are implemented

Legislation was subsequently introduced on January 24, 2013 that would change the landscape of bond financings:

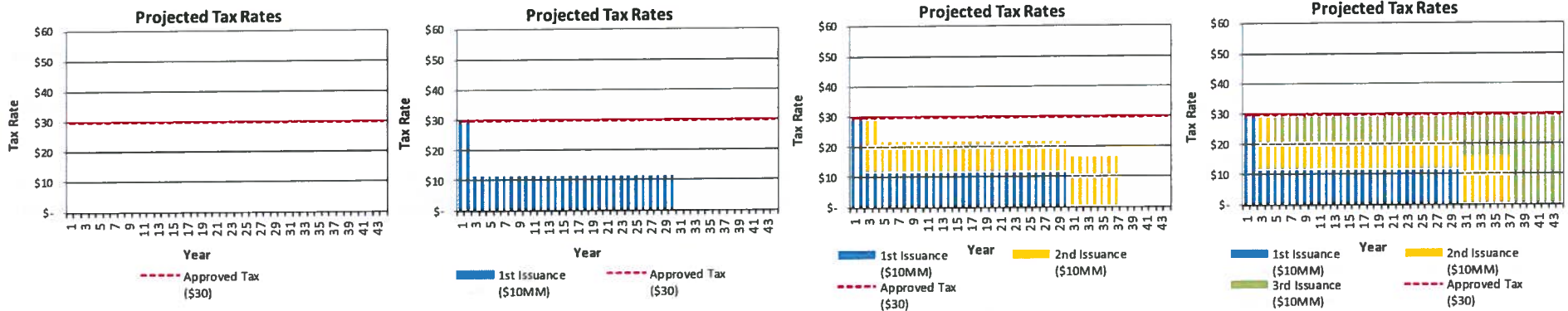
◆ Potential changes include:

- Limiting the maximum maturity of a bond from 40 years to 25 years
- Reducing the maximum interest rate on a bond from 12 percent to 8 percent
- Requiring one of three governmental entities (the county board of supervisors, the county superintendent of schools or the governing board of a community college district) to approve school district bond financing plans
- Requiring public analysis if CABs are to be utilized
- Requiring CABs be subject to redemption after 10 years
- Establishing a maximum debt service repayment ratio for each bond series of 4 to 1



# Sample Bond Structuring Pre-Proposed Legislation

Under current legislation, following is how bonds would be issued to maintain a target tax rate



Principal for Bond Issuance:	\$ 10,000,000	\$ 10,000,000	\$ 10,000,000
Interest for Bond Issuance <sup>(1)</sup> :	10,451,214	18,136,031	35,944,335
Repayment for Bond Issuance:	\$ 20,451,214	\$ 28,136,031	\$ 45,944,335
Repayment Ratio for Bond Issuance:	2.05	2.81	4.59
Repayment Ratio for Bond Program:	3.15		

(1) Assumes interest rates ranging from 5.00% to 6.00%.

# Sample Bond Structuring Post-Proposed Legislation

Under **proposed** legislation, generating the same amount of proceeds on the same schedule would require a higher tax rate



Principal for Bond Issuance:	\$ 10,000,000	\$ 10,000,000	\$ 10,000,000
Interest for Bond Issuance <sup>(1)</sup> :	7,275,368	9,400,596	13,294,144
Repayment for Bond Issuance:	\$ 17,275,368	\$ 19,400,596	\$ 23,294,144
Repayment Ratio for Bond Issuance:	1.73	1.94	2.32
Repayment Ratio for Bond Program:	2.00		

(1) Assumes interest rates ranging from 4.75% to 5.75%.

# Considerations

---

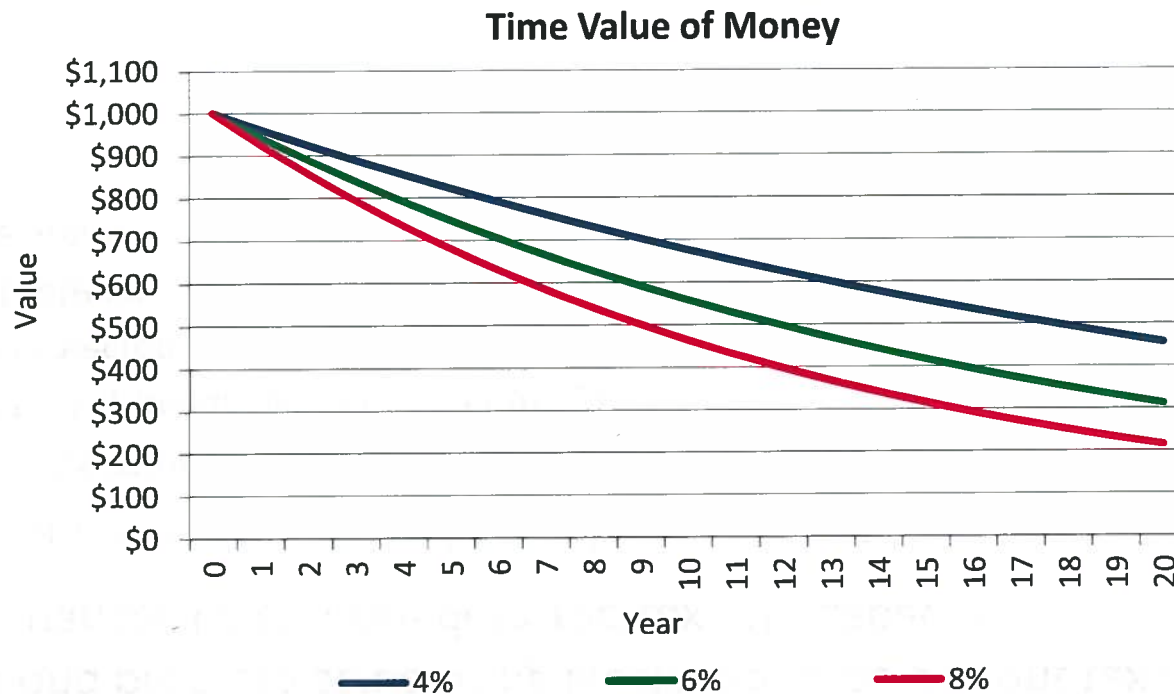
As seen in the bond program structuring illustrations, as upfront tax rate capacity is utilized, later issuances have more deferred tax rate capacity

- ◆ Repayment ratios are typically highest in later issuances
- ◆ The use of CABs may be necessary depending on:
  - District facility needs (amount and timing)
  - AV and projected growth
  - Interest rate environment
  - Tax rate limits

# Considerations

By focusing on repayment ratios, basic finance principals such as present value and the time value of money are ignored

- ◆ Project costs today versus future costs
- ◆ Future debt repaid with cheaper dollars
- ◆ Time value of money: **money today  $\neq$  money tomorrow**



# Questions?

---

